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Nos. 96-1186, 96-1187, 96-1188 and 96-1189

In the Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATED GAS DISTRIBUTORS, ET AL., PETITIONERS
v.
FEDERAL ENERGY REGULATORY COMMISSION

AMERICAN PUBLIC GAS ASSOCIATION AND CITIZENS GAS & COKE UTILITY, PETITIONERS
v.
FEDERAL ENERGY REGULATORY COMMISSION

NEW YORK PUBLIC SERVICE COMMISSION, ET AL., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA

BURLINGTON RESOURCES OIL & GAS COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION

ON PETITIONS FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

Order No. 636 of the Federal Energy Regulatory Commission (FERC) requires the unbundling of interstate natural gas transportation service from sales service in order to facilitate competition in the national market for gas at the wellhead and ensure equal access to transportation services. The questions presented are:

1. Whether FERC's jurisdiction over interstate transportation of natural gas under the Natural Gas Act, 15 U.S.C. 717 *et seq.*, supports application to local natural gas distribution companies and municipally owned natural gas companies of FERC regulations governing transfer of rights to capacity on interstate natural gas pipelines.

2. Whether FERC correctly concluded that, pursuant to its program for reallocation of pipeline capacity under long-term transportation contracts, it could not require natural gas pipelines to accept bids lower than the maximum just and reasonable rate for transportation capacity.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-174a)[1] is reported at 88 F.3d 1105. The orders of the Commission are reported in Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Pt. 284 of the Commission's Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, F.E.R.C. Stats. & Regs. (CCH) ¶ 30,939 (Pet. App. 175a-407a), order on reh'g, Order No. 636-A, F.E.R.C. Stats. & Regs. (CCH) ¶ 30,950 (Pet. App. 408a-812a), order on reh'g, Order No. 636-B, 61 F.E.R.C. (CCH) ¶ 61,272 (Pet. App. 813a-998a), reh'g denied, 62 F.E.R.C. (CCH) ¶ 61,007 (Pet. App. 999a-1000a) (Order No. 636).

JURISDICTION

The judgment of the court of appeals was entered on July 16, 1996. A petition for rehearing was denied on October 29, 1996. Pet. App. 1003a-1004a. The petitions for a writ of certiorari were filed on January 27, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In the rule at issue here, Order No. 636, the Federal Energy Regulatory Commission (FERC or Commission) completed the natural gas deregulatory program it had initiated almost a decade earlier. Order No. 636 mandates the "unbundling" of interstate natural gas sales service from transportation service, requiring that those services be sold separately to

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[1] All references to "Pet. App." are to the appendix to the petition in No. 96-1186.

natural gas purchasers. FERC adopted its mandatory unbundling policy in order to "improve the competitive structure of the natural gas industry to facilitate the operation of a national wellhead market as envisioned by Congress," Pet. App. 229a; to "ensure equality of transportation service between gas sold by pipelines or their affiliates and gas sold by other sellers," *id.* at 234a; and, ultimately, to "provide natural gas consumers with access to an adequate supply of clean and abundant natural gas at reasonable prices," *id.* at 229a. Order No. 636 imposes "capacity-release" requirements that allow holders of firm transportation rights on interstate pipelines to resell those rights under uniform terms. *Id.* at 244a-252a.[2] The order also imposes right-of-first refusal (ROFR) requirements, which allow existing shippers with long-term transportation contracts to retain their rights to pipeline capacity if they agree to match the highest bid for that service from alternative purchasers, up to the maximum cost-based transportation rate for the service approved by the Commission under the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.* Pet. App. 671a-692a.

2. In 1985, FERC initiated a deregulatory program designed to encourage the voluntary unbundling of pipeline gas sales from pipeline transportation services. Whereas pipelines had traditionally bought gas at the wellhead and transported it before turning it over to the purchaser, the Commission dramatically

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[2] Transportation is referred to as "firm" when delivery is guaranteed without interruption, as distinguished from "interruptible" transportation, which may be interrupted to accommodate the requirements of firm shippers. See Pet. App. 11a n.10.

changed the natural gas industry by enabling pipelines to offer gas sales and transportation services separately, thereby affording customers the opportunity to purchase gas from one company and hire a separate company's pipeline to transport it. See Pet. App. 10a-15a (discussing background to Order No. 636). To further enhance the efficiency of the natural gas market, the Commission encouraged pipeline customers, through a variety of mechanisms, to sell or release their unwanted firm transportation capacity to other shippers.

The partial unbundling of sales and transportation service that resulted from the voluntary program presented serious inefficiencies in allocation of unused transportation capacity. For example, because bundled firm service had often provided superior reliability, many customers continued to pay reservation fees to retain that service, while in most instances using cheaper interruptible service to transport their wellhead gas. See Pet. App. 15a-16a. The secondary transportation market that resulted from partial unbundling produced such a wide variety of capacity-reallocation arrangements that it became impossible for FERC to monitor those programs adequately in order to "ensure that all allocations are nondiscriminatory"; there were "simply too many potential assignors of capacity" for FERC to assure that capacity was allocated "in a manner consistent with the public convenience and necessity." *Algonquin Gas Transmission Co.*, 59 F.E.R.C. (CCH) ¶ 61,032, at 61,095 (Apr. 8, 1992), reh'g denied, 60 F.E.R.C. (CCH) ¶ 61,113 (Aug. 3, 1992).[3] Accordingly, the Commission

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[3] In the *Algonquin* orders, which were issued as companion orders to Order No. 636, the Commission revoked the certifi-

found that the continued operation of the voluntary capacity reallocation programs it had previously approved "would frustrate the goal of * * * remedy[ing] an unreasonable restraint of trade" and would therefore be "unjust and unreasonable and contrary to the public interest." 59 F.E.R.C. (CCH) ¶ 61,032, at 61,096-61,097.

3. To address the problems that arose from partial, voluntary unbundling, FERC's Order No. 636 mandates the complete unbundling of pipeline sales from transportation service and institutes a number of requirements to achieve a fair and open market for transportation rights, and to prevent undue discrimination. See Pet. App. 15a-18a (summarizing Order No. 636).

FERC established, *inter alia*, a uniform capacity-release rule to ensure that unneeded transportation capacity on interstate pipelines is allocated fairly and efficiently. See Pet. App. 71a-103a, as amended by Pet. App. 1001a-1002a, 244a-252a.[4] Under FERC's rule, any shipper desiring to release firm capacity must notify the affected interstate pipeline. The pipeline must then post the available capacity, along with applicable conditions, on an electronic bulletin board for a reasonable period of time, and assign the capacity to the shipper making the best offer for the capacity, up to the maximum just and reasonable price established by the Commission. *Id.* at 245a-247a. A

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cates of public convenience and necessity it had previously issued for capacity reallocation programs and required instead that pipelines abide by the uniform capacity reallocation program of Order No. 636. Review of those orders was consolidated with review of Order No. 636. Pet. App. 19a & n.20.

[4] FERC's capacity-release rule is codified at 18 C.F.R. 284.243.

shipper releasing firm capacity transportation rights may designate a specific party to receive those rights, but the pipeline must post such a prearrangement on the electronic bulletin board, and the designated party can receive the transfer only if no other party makes a better offer. *Id.* at 244a-247a. If the designated shipper bids at the ceiling rate, however, it automatically receives the transportation rights. *Id.* at 245a.

In addition, FERC recognized that, if the wellhead market for natural gas is to function effectively, transportation should be made equally available to all gas purchasers, regardless of whether the wellhead merchant is affiliated with the pipeline. Pet. App. 234a-235a. The principle of "transportation equality" protects captive customers—*i.e.* those connected to only one pipeline, who typically have long-term contracts—from the pipeline's market power. To implement that principle, Order No. 636 imposes, *inter alia*, a "right-of-first-refusal" (ROFR) process allowing competitive allocation of capacity at the expiration of long-term contracts for pipeline transportation, while protecting customers with expiring contracts who remain dependent upon continued transportation service. See *id.* at 43a-56a.

As a condition of granting pipelines authority, under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to abandon contracts at the end of their terms, FERC required pipelines to institute a ROFR mechanism inviting renewal of any long-term contract if the existing shipper matches the highest offer (up to a maximum just and reasonable rate) from any competing bidder for the transportation capacity. 18 C.F.R.

284.221(d); Pet. App. 668a-673a.[5] FERC reasoned that, in general, "a pipeline's service obligation * * * should be determined, in the first instance, by the contract negotiated by the parties," *id.* at 312a, and pipeline transportation capacity is most efficiently allocated if it is sold to those willing to pay the highest price for the capacity, *id.* at 675a. The Commission recognized, however, that where contracts for longer than one year are involved, existing customers may rely on continued service and require some assurance that their current long-term contracts can be extended.

The Commission concluded that the ROFR mechanism "strikes the appropriate balance between the needs of customers for continued service and the benefits of competition in establishing the terms of service." Pet. App. 325a.

4. The court of appeals upheld in large part FERC's Order No. 636, remanding only issues not relevant here. The court concluded that FERC's plenary jurisdiction over interstate transportation of gas on interstate pipelines gives it the authority to regulate the exchange of interstate transportation capacity. Pet. App. 71a-94a. Uniform capacity-release requirements "operate as a term or condition of pipeline service" that FERC may apply to all parties engaged in such interstate transactions, including parties that otherwise are exempt from FERC jurisdiction as local distribution companies (LDCs)

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[5] A pipeline must also extend a contract if it contains either an evergreen or a rollover clause. Such clauses allow parties to extend their contract for a specified term upon the contract's expiration. See Howard R. Williams, *Manual of Oil & Gas Terms* 406-407, 1083-1084 (8th ed. 1991).

or municipally-owned natural gas distributors (municipals). *Id.* at 80a. The court rejected petitioners' asserted distinction between "rights to" and "rendition of" service, concluding that, "[w]hile the pipeline provides *transportation* only when a party utilizes capacity rights to transport gas, the pipeline provides *transportation services* throughout the capacity release process." *Ibid.* (emphasis in original).

The court also rejected several challenges to the ROFR mechanism. Pet. App. 43a-56a.[6] The court upheld the Commission's conclusion that it could not require pipelines considering existing customers' bids under the ROFR mechanism to accept rates below the maximum just and reasonable rate. *Id.* at 53a-56a. The court also concluded that the Commission had included adequate safeguards in Order No. 636 against pipeline manipulation of bids, that there was no basis upon which to require pipelines to accept bids at less than the approved rate, and that the Commission had provided proper incentives in the ROFR process to encourage pipelines to accept discounted rates. *Ibid.*

ARGUMENT

Petitioners challenge the court of appeals' decision upholding the capacity-release and ROFR requirements of Order No. 636. That decision is consistent with the well established principle that the NGA

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[6] Although the court generally affirmed the Commission's ROFR mechanism, it remanded for further consideration the requirement that, in order to retain their existing pipeline capacity, existing shippers must match bids for terms of up to 20 years duration. Pet. App. 49a-53a. On remand, the Commission shortened the maximum term to five years. Order No. 636-C, 78 F.E.R.C. (CCH) ¶ 61,186 (Feb. 27, 1997).

granted FERC "exclusive jurisdiction 'over the sale and transportation of natural gas in interstate commerce,'" *Northwest Cent. Pipeline Corp.* v. *State Corp. Comm'n*, 489 U.S. 493, 510 (1989), and with the decisions of this and other courts construing that grant of jurisdiction. Further review is not warranted.[7]

1. Petitioners Associated Gas Distributors, et al. (AGD) (No. 96-1186), the New York Public Service Commission, et al. (NYPSC) (No. 96-1188) and the American Public Gas Association, et. al. (APGA) (No. 96-1187) challenge the court's affirmance of the capacity-release requirements in Order No. 636. The court of appeals correctly concluded that FERC's capacity-release program is a legitimate exercise of its plenary jurisdiction under the NGA to regulate the transportation of gas in interstate commerce.

a. There is no merit to petitioners' contentions (96-1186 Pet. 18-24; 96-1188 Pet. 13-16) that the Com-

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[7] Order No. 636 comports with FERC's obligation under the NGA to ensure consumers a supply of gas "at the lowest possible reasonable rate." *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, 360 U.S. 378, 388 (1959). As recent studies demonstrate, consumers have reaped substantial benefits from the Commission's decade-long restructuring of the natural gas industry, of which Order No. 636 represents the "latest step." Pet. App. 6a. Specifically, adjusted for inflation, prices paid by local utilities for gas at the "city gate" dropped by 52% in the last decade, prices paid by residential and commercial customers dropped 32% and 38%, respectively, and prices paid by industrial and electric utility customers fell by approximately 60%. Those figures demonstrate that "open access has placed strong pressures on interstate pipelines to reduce their costs and pass the savings through to their customers." Robert Crandall & Jerry Ellig, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry* 10-11 (1997).

mission lacks jurisdiction to apply its capacity-release rules to capacity on interstate pipelines held by LDCs. As the court of appeals concluded, "FERC's capacity release program is a legitimate exercise of its jurisdiction over the interstate transportation of natural gas." Pet. App. 77a. Section 1(b) of the NGA grants the Commission jurisdiction over three distinct aspects of the natural gas industry: (1) "the transportation of natural gas in interstate commerce," (2) "the sale in interstate commerce of natural gas for resale for ultimate public consumption," and (3) "natural-gas companies engaged in such transportation or sale." 15 U.S.C. 717(b); see *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (*LP&L*). As this Court has emphasized, the Commission's transportation jurisdiction is "plenary" and extends to all transactions "except those which Congress has made explicitly subject to regulation by the States." *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 216 (1964). Further, as this Court has repeatedly stressed, the Commission's power extends to regulating transactions that, if left unregulated, could interfere with the achievement of the goals of the NGA. *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 310 (1988); *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd. of Mississippi*, 474 U.S. 409, 423-424 (1986); *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529, 538 (1979).

The court of appeals' conclusion that the uniform capacity-release requirements are an appropriate exercise of FERC's jurisdiction over interstate transportation of natural gas (Pet. App. 79a-86a) follows naturally from this Court's rulings that the Commission's transportation jurisdiction extends to, for example, the end-use of the transported gas, see *FPC*

v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 7-8, 22 (1961), interruption of interstate transportation service, see *Panhandle Eastern Pipe Line Co.* v. *FPC*, 332 U.S. 507, 523 (1947), curtailment of gas sales, see *LP&L*, 406 U.S. at 641, financing of interstate pipelines, see *Schneidewind*, 485 U.S. at 306, and gas storage, see *id.* at 295 n.1. The court of appeals' decision is consistent with the decisions of all the other circuits that have addressed challenges to FERC's exercise of its transportation jurisdiction.[8]

Moreover, the court of appeals correctly noted that, "[a]s an entirely separate matter," FERC's jurisdiction over abandonments of service supports its regulation of capacity-release transactions because, "[i]n effect, the pipeline is temporarily abandoning service to the releasing shipper and instituting service to the replacement shipper." Pet. App. 80a. Under Section 7(b) and (c) of the NGA, neither abandonment nor ren-

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[8] Other circuits have unanimously held that FERC's jurisdiction extends broadly to all aspects of transportation, including the "initiation, curtailment, quality, quantity, and termination" of gas deliveries. *National Ass'n of Regulatory Util. Comm'rs* v. *FERC*, 823 F.2d 1377, 1385 (10th Cir. 1987). See, *e.g.*, *United Gas Pipe Line Co.* v. *FERC*, 824 F.2d 417, 425 (5th Cir. 1987) (limiting liability for curtailments); *Fort Pierce Util. Auth.* v. *FPC*, 526 F.2d 993, 996-998 (5th Cir. 1976) (curtailment of retail gas sales); *Corning Glass Works* v. *FERC*, 675 F.2d 392, 394-396 (D.C. Cir. 1982) (spreading of costs of liquified natural gas plant built by LDC to service customers within its territory); *Mississippi Pub. Serv. Comm'n* v. *FPC*, 522 F.2d 1345, 1350 (5th Cir. 1975) (compensating end users for losses caused by curtailments), cert. denied, 429 U.S. 870 (1976); *Panhandle E. Pipe Line Co.* v. *FPC*, 232 F.2d 467, 472 (3d Cir.) (control over the functioning of a pipeline's facilities), cert. denied, 352 U.S. 891 (1956).

dition of new service may occur without permission and prior approval of the Commission. 15 U.S.C. 717f(b) and (c).[9]

b. Petitioners incorrectly assert (96-1186 Pet. 18-21; 96-1188 Pet. 14-16) that regulation of LDCs' assignment of transportation capacity rights to gas consumers operating within the LDCs' service areas is tantamount to regulation of local distribution. Capacity-release involves assignment of rights to use firm interstate transportation capacity on high-pressure trunk lines. Those lines are not "local distribution facilities" within the meaning of Section 1(b) of the NGA. See *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 470 (1950). FERC has not in Order No. 636 asserted jurisdiction over any activity occurring behind the city gate after the LDC has received gas from an interstate pipeline. Capacity release does not solely affect LDC capacity assignments to end-users located in local service areas, but enables all firm capacity holders, including LDCs, end-users, and marketers, to deliver gas to any existing, out-of-state delivery point on the interstate pipeline upstream of its city gate or usual delivery point. See Pet. App. 271a, 555a. Deliveries of gas to those out-of-state locations under assigned capacity rights cannot be deemed local distribution of gas, nor can any State

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[9] Petitioner NYPSC asserts (96-1188 Pet. 16), without authority, that the court of appeals erred in concluding that the Commission could regulate partial abandonments of service under Section 7 of the NGA. Petitioner's argument that partial abandonments cannot be regulated would create a serious gap in the Commission's regulatory powers and, in any event, ignores the plain requirement of Section 7(b) that a pipeline may not abandon "*any* service," 15 U.S.C. 717f(b) (emphasis added), without Commission approval.

regulate those out-of-state capacity assignments. See *Mississippi River Transmission Corp.* v. *FERC*, 969 F.2d 1215, 1218 (D.C. Cir. 1992); *Michigan Consol. Gas Co.* v. *FERC*, 883 F.2d 117, 121 (D.C. Cir. 1989), cert. denied, 494 U.S. 1079 (1990).

Even where an LDC assigns its firm capacity on an interstate pipeline to a local end-user, settled precedent makes clear that such a transaction does not constitute local distribution of gas. Indeed, the "local distribution" exception to FERC transportation jurisdiction is "confined to [an LDC's] parcelling out function and (probably) even more narrowly, to parcelling out *accompanied by* retail sales." *Public Utils. Comm'n* v. *FERC*, 900 F.2d 269, 276 (D.C. Cir. 1990). Thus, contrary to petitioners' assertions (96-1186 Pet. 16; 96-1188 Pet. 19-20), the court of appeals' application here of Section 1(b)'s established construction is consistent with the holdings of this Court, *e.g.*, *LP&L*, 406 U.S. at 637-638; *East Ohio*, 338 U.S. at 469-470, and other courts of appeals, *Cascade Natural Gas Corp.* v. *FERC*, 955 F.2d 1412, 1418 (10th Cir. 1992); *United Gas Pipe Line Co.* v. *FERC*, 824 F.2d 417, 425 (5th Cir. 1987), and plainly expressed congressional intent, H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937) ("local distribution * * * is made only to consumers *in connection with sales*" (emphasis added; internal quotation marks omitted)).

c. Petitioner AGD incorrectly asserts (96-1186 Pet. 21-24) that FERC has used unbundling to interfere with matters that are traditionally controlled by the States. Petitioner ignores the pivotal fact that States have never regulated the terms and conditions of interstate pipeline transportation. As the District of Columbia Circuit explained in *Public Utils. Comm'n*, 900 F.2d at 276-277:

> In an era when transporters almost invariably bought gas at one end of the pipeline and sold it at the other, gas would normally reach an end user only after a pipeline's retail sale to that user, a transaction unquestionably under the state's control, or after conventional distribution and sale by a local distributor, again clearly subject to state control. * * * Under modern conditions, by contrast, where the end user often owns the gas and uses the pipeline solely for transportation, application of *East Ohio* removes this fulcrum for state power.

See *East Ohio*, 338 U.S. at 469-470; *Cascade Natural*, 955 F.2d at 1421.

Petitioners' contentions (96-1186 Pet. 24-28; 96-1188 Pet. 13-14) that capacity release interferes with state regulation of the LDCs' traditional role as local supplier of natural gas are similarly unfounded. An LDC's use of the capacity-release program is voluntary and is aimed at unused (and presumably unneeded) capacity. See Pet. App. 244a-245a. FERC does not regulate any aspect of the rates for an LDC's retail sale of its system supply or the use of its own facilities; it regulates only the LDC's use of interstate transportation capacity. As the court of appeals observed, Section 1(b) "does not withdraw from FERC's jurisdiction any aspect of the interstate transportation of natural gas." Pet. App. 82a.

Contrary to NYPSC's assertions (96-1188 Pet. 13-14), the uniform capacity-release mechanism is not unfair to end-users who have "paid" for LDC "pipeline capacity" through "state-approved rates." Under Order No. 636, an LDC's customer can guarantee assignment of the LDC's interstate capacity rights by

contracting with the LDC at the FERC-approved, cost-based transportation rate, or at any lower rate that trumps competing offers. Pet. App. 485a. By allowing LDCs to shed unused capacity and thereby lower costs, the capacity-release mechanism benefits consumers.

AGD incorrectly contends (96-1186 Pet. 27-28) that the capacity-release program impairs state efforts to require LDCs to unbundle local transportation service from retail sales. Rather than imposing obstacles, however, FERC's rule facilitates local unbundling by guaranteeing end-users access not only to their own LDCs' released capacity, but also to the capacity released by any other capacity holder who holds rights to a delivery point at or downstream of the LDC's position on the interstate pipeline. See Pet. App. 271a-272a, 495a-497a.[10]

d. AGD also errs in asserting (96-1186 Pet. 14-18) that the Hinshaw Amendment to the NGA, Pub. L. No. 323, 68 Stat. 36, exempts LDCs from the uniform capacity reallocation mechanism. The Hinshaw Amendment exempts from FERC regulation any person engaged in the transportation or sale in inter-

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[10] AGD argues (96-1186 Pet. 27) that Order No. 636 interferes with "blended" capacity programs now being offered by the States. That argument was neither raised before nor addressed by the Commission or the court of appeals, and there is no factual basis in the record to support it. That claim therefore is not properly presented to this Court. See 15 U.S.C. 717r(b) ("No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing."); see also *Sullivan* v. *Louisiana*, 508 U.S. 275, 279 n.1 (1993) (stating that this Court does not ordinarily review issues not raised below).

state commerce of natural gas received "within or at the boundary of a State" and "ultimately consumed within such State." 15 U.S.C. 717(c). Congress enacted the Hinshaw Amendment "to preserve state control over local distributors who purchase gas from interstate pipelines * * * [but] Congress did not intend the amendment to relieve the Commission of jurisdiction over * * * integrated interstate systems." *Louisiana Power & Light Co.* v. *FPC*, 483 F.2d 623, 633 (5th Cir. 1973), cert. denied, 416 U.S. 974 (1974). As the court of appeals explained, "the Commission's authority to regulate capacity release arises from its jurisdiction over the interstate pipeline that consummates the transaction and the subject of the transaction, the interstate transportation of gas, entirely independent of its jurisdiction over the releasing or replacement shippers." Pet. App. 82a n.62. Moreover, in order for the Hinshaw Amendment to apply, the service at issue would have to be subject to effective state regulation. The States cannot effectively regulate the transactions at issue here because they cannot prevent interstate pipelines from discriminating in favor of in-state users at the expense of out-of-state users. The Hinshaw Amendment accordingly has no application to the interstate transactions at issue here.

AGD places great weight on its contention (96-1186 Pet. 17) that the Hinshaw Amendment overruled this Court's decision in *East Ohio*, 338 U.S. at 461. Although *East Ohio*'s holding—that FERC had jurisdiction over an interstate gas pipeline operating in only one State—is no longer the law, the Hinshaw Amendment did not affect the Court's analysis in *East Ohio* of the scope of the Commission's jurisdiction over pipelines that transport gas across state lines. See

Altamont Gas Transmission Co. v. *FERC*, 92 F.3d 1239, 1246 (D.C. Cir. 1996), petition for certiorari pending, No. 96-1179 (filed Feb. 11, 1997); *Public Utils. Comm'n*, 900 F.2d at 275 n.4. Notwithstanding the particular change brought about by the Hinshaw Amendment, this Court and the courts of appeals have continued consistently to rely on *East Ohio* as a correct and otherwise still valid interpretation of the NGA. *E.g.*, *LP&L*, 406 U.S. at 636-637 & n.13; *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965); *Cascade Natural*, 955 F.2d at 1416-1421; *Public Utils. Comm'n*, 900 F.2d at 275.

e. APGA similarly contends (96-1187 Pet. 9-11) that the court of appeals erred in concluding that municipally owned gas companies must comply with the uniform capacity reallocation mechanism when they seek to reassign interstate pipeline capacity. APGA reasons that, because Section 2 of the NGA excludes municipals from the definition of "persons" regulated as "natural gas companies" under the Act, 15 U.S.C. 717a(1)-(3) and (6), FERC may not require that they comply with the terms of FERC's capacity-release program. 96-1187 Pet. 7-8. The court of appeals correctly concluded, however, that "FERC may, consistent with the NGA, require municipalities to comply with its capacity release regulations" because "FERC's transportation jurisdiction extends as a separate matter over capacity release * * * entirely independent of the jurisdictional nature of the releasing and replacement shippers." Pet. App. 84a-85a.

Although FERC lacks jurisdiction to regulate municipals as such, the Commission's jurisdiction over interstate transportation is not limited to natural-gas companies or "persons" engaged in transportation.

Instead, it extends to all interstate transportation of gas, regardless of the parties involved in such transportation. This Court has rejected the contention "that the word 'transportation' in § 1(b) must be construed as applying only to companies engaged in the business of transporting gas in interstate commerce," concluding that "the Act's language did not express any such limitation." *East Ohio*, 338 U.S. at 468. Indeed, the courts have long recognized that municipalities, although not "natural-gas companies" or "persons" under the Act, are nonetheless subject to NGA regulation under those NGA provisions that are not exclusively directed at "natural-gas companies." See, *e.g.*, *California* v. *Southland Royalty Co.*, 436 U.S. 519, 528 (1978); *Public Serv. Co.* v. *FERC*, 587 F.2d 716, 719 (D.C. Cir. 1979). Thus, as the court of appeals observed (Pet. App. 85a), this Court has concluded that the Commission may properly regulate the curtailments of both gas supply and capacity to municipals under its transportation jurisdiction, see *Transcontinental Gas*, 365 U.S. at 20-22; *LP&L*, 406 U.S. at 640—a situation involving allocation of transportation capacity among shippers in compliance with federal mandates that is "strikingly similar" to capacity release. Pet. App. 85a.[11]

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[11] APGA argues (96-1188 Pet. 13-14) that there is a distinction between transactions in the primary and secondary market for pipeline capacity. As we have noted, pages 10-11, *supra*, however, the Commission's jurisdiction over transportation extends to all aspects of interstate pipeline operation. Further, to declare such secondary transactions beyond the Commission's jurisdiction would create an anomalous gap in the comprehensive regulation intended by Congress in enacting the NGA. See *LP&L*, 406 U.S. at 631-632.

APGA further contends (96-1187 Pet. 12-19) that FERC's regulation of municipalities under its transportation jurisdiction conflicts with FERC's own policy established in *Texas Eastern Transmission Corp.*, 51 F.E.R.C. (CCH) ¶ 61,170 (May 11, 1990). The court of appeals correctly rejected that contention. Pet. App. 84a & n.64. In *Texas Eastern*, the Commission authorized firm transportation customers of an interstate pipeline to broker capacity to third parties without the involvement of the carrying pipeline itself. The Commission required such customers to obtain "limited jurisdiction" certificates under Section 7(c) of the NGA because, as brokers, they were within the meaning of NGA Section 1(b). The Commission, however, ruled that municipals were exempt transporting gas from any such certification requirement because they were not "natural gas companies" and therefore not subject to Section 7. See 48 F.E.R.C. (CCH) ¶ 61,248, at 61,873-61,875 (Aug. 22, 1989); 51 F.E.R.C. (CCH) ¶ 61,170, at 61,453-61,454. The capacity brokering arrangements in *Texas Eastern* were performed by capacity holders themselves without pipeline involvement; under Order No. 636, in contrast, FERC regulates capacity assignment by pipelines. The court of appeals thus correctly held that the *Texas Eastern* approach is inapplicable, and that FERC may require municipals' compliance with capacity-release rules as it may require their compliance with other pipeline terms or conditions of interstate transportation service. Pet. App. 84a-85a.[12]

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[12] *Texas Gas Transmission Corp.*, 55 F.E.R.C. (CCH) ¶ 61,208 (May 13, 1991), and *United Gas Pipe Line Co.*, 46 F.E.R.C. (CCH) ¶ 61,060 (Jan. 24, 1989), modified on other grounds, 49 F.E.R.C. (CCH) ¶ 61,166 (Nov. 7, 1989), followed

Finally, there is no merit to APGA's assertion (96-1187 Pet. 19-20) that the Commission's capacity-release mechanism is merely a sham designed to expand its jurisdiction. As the court of appeals observed, under Order No. 636, "[t]he pipelines' role in capacity release is absolutely central, and the transaction itself controls access to interstate transportation capacity." Pet. App. 84a-85a (footnote omitted). Order No. 636 requires pipelines to maintain electronic bulletin boards upon which proposed transactions are posted, administer the rules for operation of the bidding system, and select the successful bidder. In short, as the court observed, capacity release necessarily involves movement of gas in interstate commerce by the assignee of capacity rights because "[b]y controlling such capacity, the assignors are effectively determining by whom, and under what circumstances, gas will be transported and are using the pipeline's facilities as if they were the assignors' facilities." *Id.* at 81a.

2. Petitioner Burlington Resources Oil & Gas Company (Burlington) (No. 96-1189) argues that the court of appeals erred in affirming FERC's conclusion that pipelines allocating long-term transportation rights under the ROFR mechanism do not have to accept bids at less than the maximum, cost-based just and reasonable rate established by the Commission under the NGA. Burlington asserts (96-1189 Pet. 7-9) that the ROFR rule violates the Commission's obligation under the NGA to protect consumers. As the court of appeals concluded, however, "the basic structure of the [ROFR] mechanism provides

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the *Texas Eastern* approach, and APGA's reliance on those decisions (96-1186 Pet. 14) similarly fails to support the petition.

the [customer] protections from pipeline market power required for pre-granted abandonment under [NGA] § 7." Pet. App. 49a; see also *id.* at 54a-55a. The ROFR procedure "guarantees that existing customers may have continued service," and "affords protection to the existing customer against *any* exercise of monopoly power," *id.* at 933a (emphasis added), because the customer will be required to pay, at most, the cost-based just and reasonable rate established by the Commission in a ratemaking proceeding, *id.* at 679a. As the court of appeals observed, the NGA "protect[s] customers against loss of service only if the customer is willing to pay the maximum rate approved in a rate proceeding." *Id.* at 55a. The Commission concluded that the ROFR mechanism "provides more than adequate protection that pipelines will not be able to charge monopoly rates for their service." *Id.* at 672a. This Court approved a very similar pricing mechanism in *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United Distribution Cos.*, 498 U.S. 211 (1991) (upholding FERC rule setting maximum "just and reasonable" rate for gas sold under Natural Gas Policy Act price ceilings, but allowing sellers voluntarily to accept lower prices if market conditions dictate).[13]

Contrary to Burlington's assertions (96-1189 Pet. 11-12), FERC's decision to leave to pipelines' discretion whether to accept below-ceiling bids voluntarily does not encourage anti-competitive behavior. The

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[13] If a pipeline elects to leave capacity idle rather than accept a below-ceiling bid for that capacity, the shipper may also file a petition with the Commission under Section 5 of the NGA claiming that the pipeline's action is "unjust, unreasonable, unduly discriminatory, or preferential." 15 U.S.C. 717d(a).

Commission cannot require a pipeline to accept rates below the cost-based just and reasonable rate ceiling under the Commission's ROFR program. Those rates are, by definition, the lowest rates that ensure pipelines an adequate return on their investment; requiring pipelines to accept a lower rate would put them at risk of under-recovery in violation of the Commission's duty to ensure pipelines sufficient returns and adequate capitalization. See *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (rates must "assure confidence in the financial integrity" of the regulated entity "so as to maintain its credit and attract capital"); *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968) (rates must "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection for the relevant public interests"); *Associated Gas Distribs.* v. *FERC*, 824 F.2d 981, 1007-1013 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988).

Burlington also errs in arguing (96-1189 Pet. 12-15) that FERC should have imposed a rate within the zone of approved rates, but below the maximum just and reasonable rate. Burlington relies chiefly on *Associated Gas*. The pricing mechanism approved in *Associated Gas* established a cost-based just and reasonable rate, but allowed pipelines to "consent to selective discounting" down to prescribed minima. 824 F.2d at 1010. That voluntary discounting approach is precisely the approach taken here.[14]

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[14] Burlington misconstrues cases holding that FERC may establish rates within a "zone of reasonableness." See 96-1189 Pet. 14. That test applies to judicial review of the Commission's rates, not to the establishment of those rates in the first

Finally, Burlington errs in asserting (96-1189 Pet. 18-20) that FERC failed to provide a rationale for its decision not to require pipelines to accept discounted rates under the ROFR process, and that the court of appeals supplied its own rationale. The Commission's statement that pipelines "are not required to accept any offer at less than the maximum rate," Pet. App. 673a, correctly reflects existing law on that point. See page 22, *supra*. Each of the rationales relied upon by the court of appeals was also articulated in the Commission's orders. See Pet. App. 671a-673a, 935a-937a. In any event, a reviewing court retains the power to identify the proper construction of the governing law, even if not argued by the Commission. *Arcadia* v. *Ohio Power Co.*, 498 U.S. 73, 77 (1990).

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instance. See *Permian Basin*, 390 U.S. at 767. Burlington also asserts (96-1189 Pet. 16) that the NGA does not guarantee pipelines cost recovery, but only affords them the opportunity to recover their costs. That opportunity, however, must include the possibility of recovering adequate returns on capital investment, which, by definition, turns on the cost-based rate established by the Commission.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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